DEPARTMENT OF STATE REVENUE
LETTER OF FINDINGS: 06-0490
Sales and Use Tax
For the Year 2005

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ISSUE

I. **Sales and Use Tax –** Imposition on Aircraft Purchase.

Authority: IC § 6-8.1-5-1, IC § 6-2.5-3-2, IC § 6-2.5-3-4, IC § 6-2.5-5-8, IC § 6-2.5-4-10, IC § 6-2.5-2-1, IC § 6-2.5-8-8, 45 IAC 2.2-3-4, 45 IAC 2.2-5-15, *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289 (Ind. Tax. Ct. 2007), *Indiana Dept. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003).

Taxpayer protests denial of rental exemption and subsequent imposition of use tax on the purchase of an aircraft.

STATEMENT OF FACTS

Taxpayer purchased an aircraft but did not pay sales tax on the purchase, claiming an exemption for rental or lease to others. The Indiana Department of Revenue ("Department") reviewed the claim for exemption and determined that taxpayer did not qualify for the exemption. The Department denied the claim for exemption and issued a proposed assessment for use tax on the purchase of the aircraft. Taxpayer protests the assessment. A hearing was held where Taxpayer was represented by its principal. This Letter of Findings ensues.

Taxpayer is an Indiana corporation that came into existence, according to Taxpayer, specifically to purchase a particular kind of WWII aircraft which Taxpayer then planned to lease to a not-for-profit (NP or Lessee). According to Taxpayer, NP was formed by a group of WWII aircraft enthusiasts to purchase and exhibit a particular 1942 aircraft at air shows. According to Taxpayer, when NP was not able to raise enough money to purchase such an airplane, Taxpayer was formed by three members of NP as a for-profit corporation to purchase the aircraft with the intent of leasing it to NP. Per Taxpayer, none of its three principals serve on NP's board of directors.

On January 1, 2006, Taxpayer entered into an exclusive lease agreement with NP for a term covering January 1, 2006, to December 3, 2010. The lease requires NP to pay Taxpayer $750

per month, with a one-time $500 security deposit. NP has possession of the aircraft for the term of the lease. NP is to use the aircraft for air shows and display purposes, with no personal use by pilots permitted. Taxpayer is to bill NP for insurance premium reimbursement. NP is responsible for repair and maintenance necessary to satisfy museum quality condition and FAA regulations. Taxpayer states that NP has indeed restored – or is restoring – the aircraft using the services of volunteers with money it raised.

Additional facts will be presented as necessary.

I. **Sales and Use Tax –** Imposition on Aircraft Purchase**.**

DISCUSSION

All tax assessments are presumed to be accurate. The taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(b); *Lafayette Square Amoco, Inc. v. Indiana Dep't of Revenue*, 867 N.E.2d 289, 292 (Ind. Tax. Ct. 2007).

Indiana imposes a use tax on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction. IC § 6-2.5-3-2; 45 IAC 2.2-3-4. IC § 6-2.5-3-4(a)(2) allows for a use tax exemption for property that is acquired in a transaction that is exempt from sales tax under IC § 6-2.5-5, and the property is being stored, used, or consumed for the purpose for which it was exempted. One of those exemptions is found at IC 6-2.5-5-8(b) which states that,

> Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for resale, rental, or leasing in the ordinary course of his business without changing the form of the property.

The rental exemption set out in IC § 6-2.5-5-8 is further explained in 45 IAC 2.2-5-15, which states:

> (a) The state gross retail tax shall not apply to sales of any tangible personal property to a purchaser who purchases the same for the purpose of reselling, renting or leasing, in the regular course of the purchaser's business, such tangible personal property in the form in which it is sold to such purchaser.
>
> (b) General rule. Sales of tangible personal property for resale, renting or leasing are exempt from tax if all of the following conditions are satisfied:
>
> > (1) The tangible personal property is sold to a purchaser who purchases this property to resell, rent or lease it;
> > (2) The purchaser is occupationally engaged in reselling, renting or leasing such property in the regular course of his business; and
> > (3) The property is resold, rented or leased in the same form in which it was purchased.

This exemption, therefore, requires compliance with three elements. One of these requirements is that the Taxpayer must be engaged in the reselling, renting, or leasing of such property in its regular course of business.

When a taxpayer claims it is entitled to a tax exemption, it bears the burden of proving that the terms of the exemption have been met. *Indiana Dep't. of Revenue v. Interstate Warehousing,* 783 N.E.2d 248, 250 (Ind. 2003). The Department will strictly construe the exemption statutes against the taxpayer claiming the exemption. *Id*.

If Taxpayer bought the aircraft for the purpose of leasing it to others, Taxpayer was not required to pay sales tax on the purchase price because Taxpayer bought the plane for "an exempt purpose." IC § 6-2.5-4-10(a) states that, "A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person." Indiana imposes a sales tax on retail transactions made in Indiana. IC § 6-2.5-2-1(a). The tax is imposed on the purchaser of the property. The retail merchant, however, is tasked with collecting the tax and holds it in trust until it is remitted to the state. IC § 6-2.5-2-1(b). So, once a person – such as Taxpayer – gets into the business of leasing aircraft, that person is required to collect sales tax on the lease payments.

Therefore, one necessary indicator that Taxpayer is in the business of renting or leasing an aircraft is evidence of a stream of rental income along with sales tax collected and remitted to the Department on that stream of income. In order to substantiate that it has lease income, Taxpayer provided, post-hearing, a 2006 profit and loss statement showing lease income of $7,000, $1,266 in insurance expense [annual premium from 10/25/2005 until 10/25/2006 was $4,047], and $5,295.45 of interest expense for net income of $439. The profit and loss statement does not have any identifying markings. The source of the lease income is not identified on the statement. Neither are the insurance and interest expenses. Taxpayer did not provide any other documentation as to the source of income, cost of insurance and interest expenses.

Even assuming the lease income referenced above is from NP (Lessee), IC § 6-2.5-2-1 requires Taxpayer to collect sales tax from Lessee. While there is evidence of a lease agreement between Taxpayer and Lessee, Taxpayer has not reported any sales to the Department. Nor has Taxpayer collected or remitted sales tax on its monthly rental income stream from Lessee as required by IC § 6-2.5-2-1. Taxpayer was not provided a sales tax exemption certificate by Lessee, nor did Taxpayer request a sales tax exemption certificate from Lessee as required by IC § 6-2.5-8-8.

Furthermore, Taxpayer's insurance policy "Use of the Aircraft" (Item #10) condition reads: "The aircraft will be used for your pleasure and business related purposes where no charge is made for such use and also will be used for the following purposes: NO OTHER USE APPROVED." Taxpayer suggested that insurance companies did not treat this stipulation as precluding lease arrangements and offered to provide documentation in support of this proposition. After the hearing, Taxpayer forwarded an email response from an insurer (other than the Taxpayer's insurer); however, this email specifically explained that:

> Item #10 in the policy which discusses no charges to others is directed toward 3rd parties. [Taxpayer's insurer], as well as any other aviation insurance company we

> might speak of, understands there is often internal rental of the plane between the shell corp. and its principals. You [Taxpayer] phrased this as "members" which is fine, as long as they are principals in the corporation and known to the insurance company. These people would not be considered "others." … Therefore, any charges made to them [the principals] would not be considered charges to others.

The above explanation confirms that rental to third parties would indeed violate the insurance policy's terms, contrary to Taxpayer's understanding. According to the quoted explanation, only use of the aircraft by Taxpayer's own principals is covered under the insurance policy. This point is further emphasized in the endorsements to the policy. In this case, however, Taxpayer is leasing the aircraft to a third party, NP. This violates the terms of Taxpayer's insurance policy. Taxpayer is therefore underinsured. Taxpayer's confusion may be because Taxpayer's principal is, according to the 2006 insurance policy, the sole pilot authorized to fly the airplane (according to Taxpayer's principal, he does so as a volunteer for NP). Taxpayer may be conflating its relationship with NP, but in actuality NP is a third party relative to Taxpayer. This issue of underinsurance may not be determinative on its own of whether or not Taxpayer is leasing the aircraft in the regular course of its business, but, taken with other factors, it calls the argument for exemption into question.

Taxpayer has not provided sufficient documentation to establish that there is, in fact, a lease stream. Taxpayer has not provided any documentation to establish that it received any payments from Lessee. Taxpayer has not reported sales to the Department. Taxpayer has not collected – nor remitted to the Department - sales tax from Lessee. Taxpayer has not shown that Lessee is exempt from payment of sales tax. Taxpayer is underinsured. Taxpayer, therefore, has not met its burden to establish that it is in the business of leasing an aircraft. The Indiana Supreme Court has held that exemption statutes are strictly construed against a taxpayer; a taxpayer has the burden of establishing its entitlement to an exemption. *Indiana Dep't. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003). Taxpayer has not substantiated a qualified exempt use.

FINDING

Taxpayer's protest is respectfully denied.

LS/JR/DK – September 7, 2007